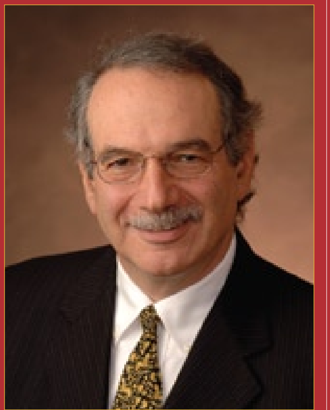
By James A. Rubenstein

Mergers and Acquisitions - Bargains Abound, but Buyers Beware



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"Buyer's remorse" is that sinking feeling that the price you paid for an asset is too high. A different kind of buyer's remorse can occur if the price paid was too low. This remorse can come long after the sale is completed, when the buyer receives a demand to either return the property or pay more for it because the sale was a fraudulent transfer.

In today's economic climate where there are bargains aplenty for real estate, businesses, and even antiques, a potential buyer should be wary of fraudulent transfer laws that can be applied to almost any kind of sale where the seller is in financial difficulty at the time of sale or gets into difficulty shortly after the sale.

Fraudulent transfer law provides a remedy to creditors when a debtor has disposed of assets for less than their value in an attempt to delay, hinder, or defraud its creditors. The concept can be traced back to early Roman law.

The ancient concept was simple. Imagine, if you will, a medieval creditor with a judgment against a blacksmith. The sheriff is asked to seize the blacksmith's horse and sell it to satisfy the judgment. The blacksmith protests and says that it is not his horse. He produces a bill of sale showing that the horse was sold last week to his sister-in-law for a shilling. The sister-in-law has then been kind enough to loan the horse to the blacksmith, but because it does not belong to him, the sheriff cannot seize it and sell it.

The blacksmith has no other way to satisfy the judgment, and the horse was sold for a fraction of its actual value to a relative. Neither the blacksmith nor the sister-in-law are likely ever to directly admit that this was a sham transaction. The law of fraudulent transfer allows the court to conclude, based on the circumstances, that clear "badges of fraud" existed and that the horse was sold with the intent to delay, hinder, or defraud creditors. This allows the creditor to recover the horse from the sister-in-law to satisfy the judgment.

Over the centuries, the "badges of fraud" have expanded to address a wide variety of modern transactions, whether simple or complex. Fraudulent transfer claims are now made in a variety of situations, including distributions from Ponzi schemes, leveraged buyouts, the sale of business assets, and any other transaction where there is cause to believe that the seller was insolvent, or on the brink of insolvency, when the transfer occurred.

Although interpretations of the fraudulent transfer laws of individual states and the United States Bankruptcy Code may vary, there are two basic outcomes depending on the nature of the transaction. If the buyer pays for the property with cash or something of value and takes it in good faith, the buyer is liable to return the property or its value. Such a buyer is often able to keep the property by paying the difference between the price paid and the property's actual value. The buyer also may have some protection of its investment by a lien on returned property in the amount of the price it paid plus any improvements to the property after the transfer. On the other hand, if the transfer was not for value and in good faith, the buyer may lose all rights to the property without protection. "Good faith" is determined on a case-by-case basis, and largely involves an inquiry into whether the buyer knew or should have known that the sale was a fraudulent transfer.

Bargain hunters in today's market should be wary of the following red flags in any potential business or commercial real estate purchase:

1. **The seller is in some financial distress.** Usually, if the seller is solvent and has sufficient assets to satisfy all of its creditors both before and after the transaction, the question of a fraudulent transfer does not arise. On the other hand, a fraudulent transfer action can be brought many years after the transfer occurs and hindsight may be used to the buyer's disadvantage.

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2. **The seller is a relative or close friend.** In general, insider transactions are scrutinized more closely than arm's-length transactions between third parties in an open market.

3. **The seller wants to be part of the acquiring company.** Typically, the courts will look closely at a transfer of a business that takes on some new investors but leaves the old owners in substantial control of the assets.

4. **The new business will have the same name, location, customers, and managers as the old business.** In general, in connection with a change in ownership, a true change in the identity of the business will help to suppress the suspicion of a fraudulent transfer.

5. **The price is below a reasonable value under the circumstances.** A buyer should be satisfied that the deal is a reasonable one. When in doubt, the situation may warrant consultation with an expert on whether the price is reasonable.

As with any legal concept as old as that of fraudulent transfers, there are many variations, exceptions, conditions, and qualifications to the application of the general principles described in this article. Each fact situation should be analyzed on its own by someone who is aware of the details of the fraudulent transfer laws.

Basically, if a deal is too good to be true, it probably is!